

San Diego Regional Building Authority

Request for Proposals

Provide Property Management Services
for the James R. Mills Building and Auto Park

1997 IRS TAX REVENUE PROCEDURE 97-13

OUTLINE OF MANAGEMENT CONTRACTS

Below is a brief summary of the federal tax limitations which may arise in connection with the provision of management services at any bond-financed property. In particular, a contract with a private entity to manage any of the facilities must comply with guidelines promulgated by the Internal Revenue Service (the "Service") in Revenue Procedure 97-13.

1. **Reasonable Compensation.** The service provider's compensation must be reasonable.
2. **No Part of the Compensation May be Based on Net Profits.** None of the service provider's compensation may be based on a share of net profits from the operation of the facilities. Generally, compensation based on a percentage of gross revenues, a capitation fee, or a per-unit fee, is not considered to be based on the share of net profits. Capitation fee contracts include HMO-type arrangements with service providers (not likely to be relevant here). A per-unit fee means, for example, a stated dollar amount for each unit of service provided (e.g., food or beverage item).
3. **Permitted Compensation Arrangements.** The service provider's compensation for services rendered must be pursuant to one of the following methods:
 - (i) at least 95 percent of annual compensation is based on a periodic fixed fee, with a contract term not exceeding the lesser of 80 percent of the useful life of the property or fifteen (15) years;
 - (ii) at least 80 percent of the annual compensation is based on a periodic fixed fee, with a contract term not exceeding the lesser of 80% of the useful life of the property or ten (10) years.
 - (iii) at least 50 percent of the annual compensation is based on a periodic fixed fee, with a contract term not exceeding five (5) years. In this case, the contract must be terminable by the Issuer on reasonable notice, without cause or penalty, at the end of the third year of the contract.

- (iv) in the case of certain contracts with a term not longer than three (3) years, the compensation may be based on a per-unit fee or combination of a per-unit fee and a periodic fixed fee and the contract must be cancelable after two years, without cause or penalty.
 - (v) in the case of certain contracts with a term not longer than two (2) years, the compensation may be based on a percentage of fees charged, provided the contract is cancelable by the Issuer after one year.
4. **Incentives.** In the case of ten and fifteen year contracts, described above, fees will not fail to qualify as "fixed" even though there may be a one-time incentive award during the term of the contract under which compensation is automatically increased when a specific gross revenue (or expense target) is reached. The award must be equal to a single, stated dollar amount.
5. **No Related Parties or Common Control.** Neither the Issuer nor the service provider may control more than 20 percent of the voting power of the other's governing board.
6. **Renewal options.** Generally, renewal options are taken into account in computing the term of the management contract. However, such options only are counted if the service provider has a legally enforceable right to renew the contract. Thus, options to extend at the discretion of the Issuer, by mutual consent, or automatic one-year renewals subject to cancellation notice, are not counted as part of the term of the contract.

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For more information about revenue procedures see [Revenue Procedure 89-14](#), or, the [Guide to Understanding the Differences Among Official IRS Documents](#).

Revenue Procedures are in the Adobe Acrobat PDF format. Internal Revenue Bulletin Summary pages are in HTML format.

Revenue Procedures	Bulletin	Date of IRB
Rev. Proc. 97-61 (PDF, 58K) On-line filing program; Form 1040. Participants in the 1998 On-Line Filing Program for the Form 1040 Series are informed of their obligations to the Service, taxpayers, and other participants.	IRB #1997-52 (HTML)	Dec. 29, 1997
Rev. Proc. 97-60 (PDF, 80K) Electronic filing program; Form 1040. Participants in the 1998 Electronic Filing Program for the Form 1040 Series are informed of their obligations to the Service, taxpayers, and other participants.	IRB #1997-52 (HTML)	Dec. 29, 1997
Rev. Proc. 97-59 (PDF, 51K) Per them allowances. This procedure provides optional rules for deeming substantiated the amount of certain reimbursed traveling expenses of an employee as well as for determining the amount of deductible meals while traveling away from home. Rev. Proc. 96-64 superseded.	IRB #1997-52 (HTML)	Dec. 29, 1997
Rev. Proc. 97-58 (PDF, 49K) Optional standard mileage rates. This procedure announces 32.5 cents as the optional rate for deducting or accounting for expenses for business use of an automobile, 14 cents as the optional rate for deducting or accounting for use of an automobile as a charitable contribution, and 10 cents as the optional rate for deducting or accounting for use of an automobile as a medical or moving expense for 1998. It provides rules for substantiating the deductible expenses of using an automobile for business, moving, medical, or charitable purposes. Rev. Proc. 96-63 superseded.	IRB #1997-52 (HTML)	Dec. 29, 1997
Rev. Proc. 97-57 (PDF, 25K) Cost-of-living adjustments for 1998. The Service provides cost-of-living adjustments for the tax rate tables for individuals, estates, and trusts, the standard deduction amounts, the personal exemption, and several other items that use the adjustment method provided for the tax rate tables. The Service also provides the adjustment for eligible long-term care premiums and another item that uses the adjustment method provided for eligible long-term care premiums.	IRB #1997-52 (HTML)	Dec. 29, 1997
Rev. Proc. 97-56 (PDF, 24K) Penalties; substantial understatement. Guidance is provided concerning when information shown on a return in accordance with the applicable forms and instructions will be adequate	IRB #1997-52 (HTML)	Dec. 29, 1997

proceeds as a result of an action subsequent to the issue date.

Rev. Proc. 97-14 (PDF, 24K) **IRB #1997-5** (HTML) Feb. 3, 1997
Tax-exempt bonds; private activity bonds. This procedure sets forth conditions under which a research agreement does not result in private business use under section 141(b) of the Code. This procedure also applies to determinations of whether a research agreement causes the test in section 145(a)(2)(B) of the Code to be met for qualified 501(c)(3) bonds.

Rev. Proc. 97-13 (PDF, 31K) **IRB #1997-5** (HTML) Feb. 3, 1997
Tax-exempt bonds; private activity bonds. This procedure sets forth conditions under which a management contract does not result in private business use under section 141(b) of the Code. This procedure also applies to determinations of whether a management contract causes the test in section 145(a)(2)(B) to be met for qualified 501(c)(3) bonds.

Rev. Proc. 97-12 (PDF, 19K) **IRB #1997-4** (HTML) Jan. 27, 1997
Unrelated business taxable income. This procedure provides guidance to tax-exempt organizations regarding when associate member dues payments will be treated as gross income of an unrelated trade or business under section 512 of the Code. Rev. Proc. 95-21 modified and amplified.

Rev. Proc. 97-11 (PDF, 15K) **IRB #1997-6** (HTML) Feb. 10, 1997
Photocopy fee increase. Effective May 1, 1997, the fee for a copy of a tax return or other related document will increase from \$14 to \$23. The next revision of Form 4506 will reflect the \$23 charge. Rev. Procs. 66-3 and 87-21 modified. Rev. Proc. 94-52 revoked.

Rev. Proc. 97-10 (PDF, 22K) **IRB #1997-2** (HTML) Jan. 13, 1997
Change in computing depreciation for retail motor fuels outlets. This procedure is provided for making the election under section 1120 of the Small Business Job Protection Act of 1996 to treat retail motor fuels outlets placed in service before August 20, 1996, as 15-year property under section 168 of the Code. Rev. Proc. 92-20 modified.

Rev. Proc. 97-9 (PDF, 33K) **IRB #1997-2** (HTML) Jan. 13, 1997
Cash or deferred arrangements; amendments; SIMPLEs. This procedure describes how an employer that maintains a qualified cash or deferred arrangement may make the necessary amendment for its qualified cash or deferred arrangement to meet the provision for a savings incentive match plan pursuant to section 1422 of the Small Business Job Protection Act of 1996.

Rev. Proc. 97-8 (PDF, 72K) **IRB #1997-1** (HTML) Jan. 6, 1997
User fees for employee plans and exempt organizations. Up-to-date guidance for complying with the user fee program of the Service as it pertains to requests for letter rulings, determination letters, etc., on matters under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations), is provided. Rev. Proc. 96-8 superseded.

Rev. Proc. 97-7 (PDF, 31K) **IRB #1997-1** (HTML) Jan. 6, 1997
Areas in which advance rulings will not be issued: Associate Chief Counsel (International). This procedure lists the subject matters under the jurisdiction of the Associate Chief Counsel (International) in which the Service will not issue advance letter rulings or determination letters. Rev. Proc. 96-7 superseded.

Rev. Proc. 97-6 (PDF, 112K) **IRB #1997-1** (HTML) Jan. 6, 1997
Employee plans determination letters. Revised procedures are provided for issuing determination letters on the qualified status of employee plans under sections 401(a), 403(a), 409, and 4975 of the Code. Rev. Proc. 96-6 superseded.

Rev. Proc. 97-5 (PDF, 75K) **IRB #1997-1** (HTML) Jan. 6, 1997
Technical advice. Revised procedures are provided for furnishing technical advice to key district directors and chiefs, appeals offices, by the Assistant Commissioner (Employee Plans and Exempt Organizations) regarding issues in the employee plans areas (including actuarial matters) and exempt organizations areas. Rev. Proc. 96-5 superseded.

Rev. Proc. 97-4 (PDF, 118K) **IRB #1997-1** (HTML) Jan. 6, 1997
Rulings and determination letters; issuance procedures. Revised procedures are provided for

Rev. Proc. 97-13

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth conditions under which a management contract does not result in private business use under § 141(b) of the Internal Revenue Code of 1986. This revenue procedure also applies to determinations of whether a management contract causes the test in § 145(a)(2)(B) of the 1986 Code to be met for qualified 501(c)(3) bonds.

SECTION 2. BACKGROUND

.01 Private Business Use.

(1) Under § 103(a) of the 1986 Code, gross income does not include interest on any state or local bond. Under § 103(b)(1) of the 1986 Code, however, § 103(a) of the 1986 Code does not apply to a private activity bond, unless it is a qualified bond under § 141(e) of the 1986 Code. Section 141(a)(1) of the 1986 Code defines "private activity bond" as any bond issued as part of an issue that meets both the private business use and the private security or payment tests. Under § 141(b)(1) of the 1986 Code, an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Under § 141(b)(6)(A) of the 1986 Code, private business use means direct or indirect use in a trade or business carried on by any person other than a governmental unit. Section 145(a) of the 1986 Code also applies the private business use test of § 141(b)(1) of the 1986 Code, with certain modifications.

(2) Corresponding provisions of the Internal Revenue Code of 1954 set forth the requirements for the exclusion from gross income of the interest on state or local bonds. For purposes of this revenue procedure, any reference to a 1986 Code provision includes a reference to the corresponding provision, if any, under the 1954 Code.

(3) Private business use can arise by ownership, actual or beneficial use of property pursuant to a lease, a management or incentive payment contract, or certain other arrangements. The Conference Report for the Tax Reform Act of 1986, provides as follows:

The conference agreement generally retains the present-law rules under which use by persons other than governmental units is determined for purposes of the trade or business use test. Thus, as under present law, the use of bond-financed property is treated as a use of bond proceeds. As under present law, a person may be a user of bond proceeds and bond-financed property as a result of (1) ownership or (2) actual or beneficial use of property pursuant to a lease, a management or incentive payment contract, or (3) any other arrangement such as a take-or-pay or other output-type contract.

2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-687-688, (1986) 1986-3 (Vol. 4) C.B. 687-688 (footnote omitted).

(4) A management contract that gives a nongovernmental service provider an ownership or leasehold interest in financed property is not the only situation in which a contract may result in private business use.

(5) Section 1.141-3(b)(4)(i) of the Income Tax Regulations provides, in general, that a management contract (within the meaning of § 1.141-3(b)(4)(ii)) with respect to financed property may result in private business use of that property, based on all the facts and circumstances.

(6) Section 1.141-3(b)(4)(i) provides that a management contract with respect to financed property generally results in private business use of that property if the contract provides for compensation for services rendered with compensation based, in whole or in part, on a share of net profits from the operation of the facility.

(7) Section 1.141-3(b)(4)(iii), in general, provides that certain arrangements generally are not treated as management contracts that may give rise to private business use. These are—

(a) Contracts for services that are solely incidental to the primary governmental function or functions of a financed facility (for example, contracts for janitorial, office equipment repair, hospital billing or similar services);

(b) The mere granting of admitting privileges by a hospital to a doctor, even if those privileges are conditioned on the provision of de minimis services, if those privileges are available to all

qualified physicians in the area, consistent with the size and nature of its facilities;

(c) A contract to provide for the operation of a facility or system of facilities that consists predominantly of public utility property (as defined in § 168(i)(10) of the 1986 Code), if the only compensation is the reimbursement of actual and direct expenses of the service provider and reasonable administrative overhead expenses of the service provider; and

(d) A contract to provide for services, if the only compensation is the reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties.

(8) Section 1.145-2(a) provides generally that §§ 1.141-0 through 1.141-15 apply to § 145(a) of the 1986 Code.

(9) Section 1.145-2(b)(1) provides that in applying §§ 1.141-0 through 1.141-15 to § 145(a) of the 1986 Code, references to governmental persons include section 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a) of the 1986 Code.

.02 *Existing Advance Ruling Guidelines.* Rev. Proc. 93-19, 1993-1 C.B. 526, contains advance ruling guidelines for determining whether a management contract results in private business use under § 141(b) of the 1986 Code.

SECTION 3. DEFINITIONS

.01 *Adjusted gross revenues* means gross revenues of all or a portion of a facility, less allowances for bad debts and contractual and similar allowances.

.02 *Capitation fee* means a fixed periodic amount for each person for whom the service provider or the qualified user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to covered persons varies substantially. For example, a capitation fee includes a fixed dollar amount payable per month to a medical service provider for each member of a health maintenance organization plan for whom the provider agrees to provide all needed medical services for a specified period. A capitation fee may include a variable component of up to 20 percent of the total capitation fee designed to

protect the service provider against risks such as catastrophic loss.

.03 *Management contract* means a management, service, or incentive payment contract between a qualified user and a service provider under which the service provider provides services involving all, a portion of, or any function of, a facility. For example, a contract for the provision of management services for an entire hospital, a contract for management services for a specific department of a hospital, and an incentive payment contract for physician services to patients of a hospital are each treated as a management contract. See §§ 1.141-3(b)(4)(ii) and 1.145-2. .

.04 *Penalties* for terminating a contract include a limitation on the qualified user's right to compete with the service provider; a requirement that the qualified user purchase equipment, goods, or services from the service provider; and a requirement that the qualified user pay liquidated damages for cancellation of the contract. In contrast, a requirement effective on cancellation that the qualified user reimburse the service provider for ordinary and necessary expenses or a restriction on the qualified user against hiring key personnel of the service provider is generally not a contract termination penalty. Another contract between the service provider and the qualified user, such as a loan or guarantee by the service provider, is treated as creating a contract termination penalty if that contract contains terms that are not customary or arm's-length that could operate to prevent the qualified user from terminating the contract (for example, provisions under which the contract terminates if the management contract is terminated or that place substantial restrictions on the selection of a substitute service provider).

.05 *Periodic fixed fee* means a stated dollar amount for services rendered for a specified period of time. For example, a stated dollar amount per month is a periodic fixed fee. The stated dollar amount may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility. For example, the Consumer Price Index and similar external indices that track increases in prices in an area or increases in revenues or costs in an industry are objective external standards. Capitation fees and per-unit fees are not periodic fixed fees.

.06 *Per-unit fee* means a fee based on a unit of service provided specified in the contract or otherwise specifically determined by an independent third party, such as the administrator of the Medicare program, or the qualified user. For example, a stated dollar amount for each specified medical procedure performed, car parked, or passenger mile is a per-unit fee. Separate billing arrangements between physicians and hospitals generally are treated as per-unit fee arrangements.

.07 *Qualified user* means any state or local governmental unit as defined in § 1.103-1 or any instrumentality thereof. The term also includes a section 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a) of the 1986 Code. The term does not include the United States or any agency or instrumentality thereof.

.08 *Renewal option* means a provision under which the service provider has a legally enforceable right to renew the contract. Thus, for example, a provision under which a contract is automatically renewed for one-year periods absent cancellation by either party is not a renewal option (even if it is expected to be renewed).

.09 *Service provider* means any person other than a qualified user that provides services under a contract to, or for the benefit of, a qualified user.

SECTION 4. SCOPE

This revenue procedure applies when, under a management contract, a service provider provides management or other services involving property financed with proceeds of an issue of state or local bonds subject to § 141 or § 145(a)(2)(B) of the 1986 Code.

SECTION 5. OPERATING GUIDELINES FOR MANAGEMENT CONTRACTS

.01 *In general.* If the requirements of section 5 of this revenue procedure are satisfied, the management contract does not itself result in private business use. In addition, the use of financed property, pursuant to a management contract meeting the requirements of section 5 of this revenue procedure, is not private business use if that use is functionally related and subordinate to that management contract and that use is not, in substance, a separate contractual agreement (for example, a separate lease of a portion of the financed property). Thus,

for example, exclusive use of storage areas by the manager for equipment that is necessary for it to perform activities required under a management contract that meets the requirements of section 5 of this revenue procedure, is not private business use.

.02 *General compensation requirements.*

(1) *In general.* The contract must provide for reasonable compensation for services rendered with no compensation based, in whole or in part, on a share of net profits from the operation of the facility. Reimbursement of the service provider for actual and direct expenses paid by the service provider to unrelated parties is not by itself treated as compensation.

(2) *Arrangements that generally are not treated as net profits arrangements.* For purposes of § 1.141-3(b)(4)(i) and this revenue procedure, compensation based on—

(a) A percentage of gross revenues (or adjusted gross revenues) of a facility or a percentage of expenses from a facility, but not both;

(b) A capitation fee; or

(c) A per-unit fee is generally not considered to be based on a share of net profits.

(3) *Productivity reward.* For purposes of § 1.141-3(b)(4)(i) and this revenue procedure, a productivity reward equal to a stated dollar amount based on increases or decreases in gross revenues (or adjusted gross revenues), or reductions in total expenses (but not both increases in gross revenues (or adjusted gross revenues) and reductions in total expenses) in any annual period during the term of the contract, generally does not cause the compensation to be based on a share of net profits.

(4) *Revision of compensation arrangements.* In general, if the compensation arrangements of a management contract are materially revised, the requirements for compensation arrangements under section 5 of this revenue procedure are retested as of the date of the material revision, and the management contract is treated as one that was newly entered into as of the date of the material revision.

.03 *Permissible Arrangements.* The management contract must be described in section 5.03(1), (2), (3), (4), (5), or (6) of this revenue procedure.

(1) *95 percent periodic fixed fee arrangements.* At least 95 percent of the compensation for services for each annual period during the term of the

contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 15 years. For purposes of this section 5.03(1), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

(2) *80 percent periodic fixed fee arrangements.* At least 80 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee. The term of the contract, including all renewal options, must not exceed the lesser of 80 percent of the reasonably expected useful life of the financed property and 10 years. For purposes of this section 5.03(2), a fee does not fail to qualify as a periodic fixed fee as a result of a one-time incentive award during the term of the contract under which compensation automatically increases when a gross revenue or expense target (but not both) is reached if that award is equal to a single, stated dollar amount.

(3) *Special rule for public utility property.* If all of the financed property subject to the contract is a facility or system of facilities consisting of predominantly public utility property (as defined in § 168(i)(10) of the 1986 Code), then "20 years" is substituted—

(a) For "15 years" in applying section 5.03(1) of this revenue procedure; and

(b) For "10 years" in applying section 5.03(2) of this revenue procedure.

(4) *50 percent periodic fixed fee arrangements.* Either at least 50 percent of the compensation for services for each annual period during the term of the contract is based on a periodic fixed fee or all of the compensation for services is based on a capitation fee or a combination of a capitation fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 5 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the third year of the contract term.

(5) *Per-unit fee arrangements in certain 3-year contracts.* All of the

compensation for services is based on a per-unit fee or a combination of a per-unit fee and a periodic fixed fee. The term of the contract, including all renewal options, must not exceed 3 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the second year of the contract term.

(6) *Percentage of revenue or expense fee arrangements in certain 2-year contracts.* All the compensation for services is based on a percentage of fees charged or a combination of a per-unit fee and a percentage of revenue or expense fee. During the start-up period, however, compensation may be based on a percentage of either gross revenues, adjusted gross revenues, or expenses of a facility. The term of the contract, including renewal options, must not exceed 2 years. The contract must be terminable by the qualified user on reasonable notice, without penalty or cause, at the end of the first year of the contract term. This section 5.03(6) applies only to—

(a) Contracts under which the service provider primarily provides services to third parties (for example, radiology services to patients); and

(b) Management contracts involving a facility during an initial start-up period for which there have been insufficient operations to establish a reasonable estimate of the amount of the annual gross revenues and expenses (for example, a contract for general management services for the first year of operations).

.04 No Circumstances Substantially Limiting Exercise of Rights.

(1) *In general.* The service provider must not have any role or relationship with the qualified user that, in effect, substantially limits the qualified user's ability to exercise its rights, including cancellation rights, under the contract, based on all the facts and circumstances.

(2) *Safe harbor.* This requirement is satisfied if—

(a) Not more than 20 percent of the voting power of the governing body of the qualified user in the aggregate is vested in the service provider and its directors, officers, shareholders, and employees;

(b) Overlapping board members do not include the chief executive officers of the service provider or its governing body or the qualified user or its governing body; and

(c) The qualified user and the service provider under the contract are not related parties, as defined in § 1.150-1(b).

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 93-19, 1993-1 C.B. 526, is made obsolete on the effective date of this revenue procedure.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for any management contract entered into, materially modified, or extended (other than pursuant to a renewal option) on or after May 16, 1997. In addition, an issuer may apply this revenue procedure to any management contract entered into prior to May 16, 1997.

DRAFTING INFORMATION

The principal author of this revenue procedure is Loretta J. Finger of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure contact Loretta J. Finger on (202) 622-3980 (not a toll-free call).